



SOUTH KOREAN FOREIGN MILITARY SALES (FMS) PROGRAM

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Author: William Shaw

*Federal Research Division
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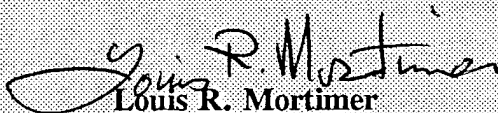
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PREFACE

This is part of a series of reports on the foreign military sales (FMS) programs of major arms-producing nations in the Free World. It has been prepared in an attempt to compile available information on how nations conduct foreign military sales. Of particular interest for each nation treated are laws governing arms exports, FMS procedures, sales promotion, and governmental export assistance.

This report is based on information from a wide range of English- and Korean-language open sources, including newspapers, periodicals, books, and official documents.

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SUMMARY

Though the Republic of Korea (ROK) had no arms producing capability until the early 1970s, by 1982 its deliveries of weapons and ammunition, quarter-master goods, and military construction ranked it 13th among the world's largest military exporting countries.

South Korea's largely private defense industries reached this export capability through incentives and financial assistance provided by favorable tax legislation and other laws. Substantial technical assistance provided by the US Government through licensing agreements with US arms manufacturers also was an important factor in South Korean arms production. New laws in the late 1970s enlarged the Defense Industry Bureau of the Ministry of National Defense (MND) and charged it with supervision of overseas defense marketing and exports.

The decision to export arms, announced by the South Korean Government in 1977, produced friction with the United States over the latter's political and licensing restrictions on ROK third country sales. South Korean defense industries also faced problems of excess production capability as a result of overinvestment under government incentives in the 1970s. In the late 1970s and early 1980s the government took firmer control of both manufacturing and exports of defense products. South Korean law provides legal penalties for "provoking foreign relations problems" or "disrupting international confidence" in selling defense goods. However, there are no laws prohibiting arms exports to countries at war.

South Korean defense industry advertising is conducted quietly. The basic level of the weaponry and the high degree of dependence on US technology tend to restrict the available markets for ROK-manufactured items. South Korean marketing also is adversely affected by increasing financial problems of potential buyers, reflected in a worldwide trend in recent years toward increasing credit sales and grant transfers of military goods. In the early 1980s, South Korea began to organize low-keyed participation in international arms exhibitions and in 1981 sponsored such an exhibition in Seoul.

Pressures for increased defense exports will continue to be influenced by such broad foreign policy goals as increased security of oil supplies, improved relations with nonaligned countries, and close security cooperation with the United States. South Korean foreign military sales also are influenced by political, economic, and military conditions in purchasing countries.

SOUTH KOREAN FOREIGN MILITARY SALES (FMS) PROGRAM

1. INTRODUCTION

Foreign military sales by the Republic of Korea (ROK) from 1978 to 1982 placed it 13th among the world's military exporting countries. During this period, South Korean military exports trailed those of Yugoslavia and North Korea, and were greater than those of Israel, Brazil, and Belgium. In 1982, South Korean military assistance and sales accounted for 3.4 percent of all non-US foreign military sales by non-Communist countries.

Table 1

Arms Transfers by Selected Countries, 1978-82

<u>Exporter</u>	<u>Value of Transfers*</u>
China (10th ranked)	1,900
Yugoslavia	1,946
North Korea	1,382
South Korea	1,242**
Israel	1,216
Brazil	1,187
Belgium	752

*Unit: \$1 million (1981 constant). Unless otherwise indicated dollars are US. Includes only actual deliveries of weapons, ammunition, support equipment, and services such as military construction and training.

**Includes \$26 million (current) in ammunition sales to Malaysia reported in ROK customs records for 1980 and 1981. Excludes \$56 million in ammunition delivered to the United States from 1980 to 1983.

[Sources: United States Arms Control and Disarmament Agency, World Military Expenditures and Arms Transfers, 1972-1982 (Washington: April 1984); Republic of Korea, Statistical Yearbook of Foreign Trade (Seoul: 1980, 1981).]

2. DEFENSE INDUSTRY DEVELOPMENT AND THE DECISION TO EXPORT

a. The Early 1970s

South Korea had no arms-producing capability until the early 1970s, and was the recipient of an average of \$250 million annually in US military assistance in the period following the Korean War from 1953 to 1981. In February 1968, 2 weeks after the unsuccessful North Korean commando raid on the presidential residence, President Park Chung Hee publicly announced that his country would develop an independent arms production capability. South Korea obtained formal US approval for development of a defense industry at the ROK-US Defense Ministers' Conference in May 1968, and initiated a 3-year defense industry organization plan in 1969. Initial financing for the defense industry came from an unrestricted loan of \$60 million from two US banks. The Joint US Military Advisory Group, Korea, also provided financial and technical

assistance, initially through the South Korean Agency for Defense Development (ADD) and later directly to the Ministry of National Defense (MND).

Further legal and financial support for the South Korean arms industry and for eventual exports of Korean-made weapons and military equipment came in 1973 with enactment of the Military Procurement Special Measures Law (hereafter Military Procurement Law) and with the Defense Surtax begun in 1975. Revenues from this tax from 1975 to 1977 totalled \$1.3 billion and eventually accounted for more than 30 percent of the defense budget. The surtax was renewed in 1980 for a second 5-year period. In 1977 President Park created a standing consultative body made up of cabinet- and sub-cabinet-level officials and key defense industry executives to plan industry growth.

South Korea's industrial, technical, and administrative infrastructure for defense production was fully operational by 1977. Mass-production capability for some basic weapons and munitions was reached by the mid-1970s (see table 2). According to South Korean Government statements, defense industry production of infantry weapons reached self-sufficient production levels by 1976. In 1976 and 1977 some 50 designated defense industries, operating under the coordination of the Defense Industry Bureau and the Defense Procurement Agency of the MND, produced weapons, communications and transport equipment, and quartermaster goods. The ADD supported technical research and development (R&D) efforts with a staff of more than 2,000 in 1980 and several branch laboratories for specialized research. Additional infrastructural depth came from technical education and data exchange agreements with the United States and increasing technical exchanges between commercial and defense production industries within South Korea.

b. The Decision to Export Defense Products

ROK Government decisions concerning the structure and scale of the new defense industries during the 1970s may have reflected the export-led growth strategy so important in overall South Korean economic development during the late 1960s and early 1970s. Although the government did not publicly announce an arms export policy until 1977, an official of the MND privately told one foreign munitions manufacturer in the early 1970s that the development of defense industries should lead to an arms exporting role beyond the satisfaction of immediate ROK military procurement needs. In 1974 the US State Department reportedly granted approval in principle for South Korean sales of co-produced weapons to Malaysia, Cameroon, and Kuwait. By the late 1970s, it was evident that exporting had become not only formal policy but a necessity for the defense industry; overinvestment had generated excess production capacity and key defense industries needed overseas sales to maintain workable operational levels.

Table 2

ROK Defense Industry Production in the Early 1970s

<u>Item</u>	<u>Initial Production</u>	<u>Mass Production</u>
81-mm mortar	1971	1973
3.5-inch rocket	1971	1973
M16 rifle	1971 or 1972	unk
105-mm howitzer	1972	1977
60-mm mortar	1972	1975
4.2-inch mortar	1972	1975
40-mm ammunition	1972	1974
81-mm ammunition	1972	1973
60-mm ammunition	1972	1973
M15, M19 antitank mine	1972	1973
3.5-inch rocket launcher	1972	1973
fragmentation grenade	1972	1973
106-mm recoilless rifle	1973	1975
155-mm howitzer	1974	1977
mine detector	1974	1976
20-mm antiaircraft gun	1974	1977
K2 rifle	1974	unk
K3 machinegun	1974	unk
500-lb bomb	1975	1977
250-lb bomb	1975	1975

[Sources: Im Chong-hwi, "Pangwi sanop ui munjechom gwa taech'aek" [The Defense Industries: Problems and Growth Policies], Kukhoebo [National Assembly Journal], Seoul, no. 189, July 1982, pp. 97-103; Paek Hwan-gi, "Pangwi sanop ui hyonhwang gwa chonmang" [Present Situation and Prospects of the Defense Industry], Kukhoebo, no. 146, July 1978, pp. 66-69; US House of Representatives, Subcommittee on International Relations of the Committee on International Relations, Investigation of Korean-American Relations (Washington, D.C.: Government Printing Office, 31 October 1978), pp. 74-88.]

The Administrative White Paper of 1977 stated the South Korean Government's intention to continue to expand the defense industries and to seek exports of defense products. Overseas defense industry deliveries dramatically increased to approximately \$110 million in 1977 from \$5 million (current) in 1976. This was a marketing breakthrough, especially for producers of quartermaster goods and other military software. However, South Korean efforts to secure US permission to export co-produced or licensed military hardware were not uniformly satisfactory. For example, negotiations for export of M16 rifles, produced under license with Colt Industries since 1972, were unsuccessful. South Korea did obtain US permission for the sale of 170 mortars to Thailand in 1977. Fast patrol boats produced under license by Korea Tacoma Marine Industry were modified slightly and exported to Indonesia in 1977 and 1978 without US permission.

c. Defense Industry Planning, 1979-1983

By late 1979, defense industry planners in the MND were able to survey the accomplishments of the preceding decade with a well publicized sense of satisfaction. The Armed Forces' Day parade on 1 October 1979 featured a surface-to-surface missile apparently re-engineered from the US Nike anti-aircraft missile. Official claims of successful test firings of this weapon and premature references to other domestic guided munitions were later quietly dropped. In many other areas, however, Korean defense industries were making progress and were capable of providing the military with most of its requirements for a broad range of basic weapons, ammunition, and equipment (see table 3). The South Korean Government cautiously began to release information on exports of quartermaster goods, infantry weapons, munitions, landing craft, and high speed boats.

Table 3

New Areas of Defense Industry Production, Late 1970s

<u>Item</u>	<u>Year of Initial Production or Agreement</u>
Model 500 helicopter	1976 (under US license)
M60, M60EZ machinegun	1977 (under US license)
AN/APX-72 airborne IFF transponder	1978 (under US license)
Model 500-D helicopter	1978 (under US license)
A3, A5 refit for M48 tank	1978 or earlier
Korean armored car	1976 or 1977
fast patrol boat	1977 or 1978
landing ship, tank	1977 or 1978

[Sources: US House of Representatives, Committee on Foreign Affairs, United States Relations with Japan and Korea: Security Issues (Washington. D.C.: Government Printing Office, 1981), p. 36; Aviation and Marine International (Zurich), April 1977, n.p.; Paek Hwan-gi, "Pangwi sanop ui hyonhwang gwa chonmang" [Present Situation and Prospects of the Defense Industry], Kukhoebo [National Assembly Journal], Seoul, no. 146, July 1978, p. 67.]

Following the assassination of President Park Chung Hee in October 1979, and the military coups in December 1979 and May 1980 which put Major General Chun Doo Hwan in position for the presidency, planning for the defense industry continued in the direction the MND sought in the late 1970s. Planning goals for the defense industries through the period 1979 to 1983 included:

- o achievement of production targets for domestic defense needs;
- o promotion of exports of defense goods;
- o development of an aerospace industry capable of manufacturing aircraft;

- development of a high-technology weapon systems production capability;
- development of Korean-designed basic and complex weapons; and
- diversification of R&D efforts with selective high-tech R&D.

d. Defense Industry Problems

Government reports for the late 1970s and early 1980s show continuing problems facing South Korean defense industries. These problems in turn brought forth a variety of government strategies.

Excess production capacity is a recurring problem. Strategies have included:

- production of civilian goods at defense industry plants;
- awarding contracts in advance of production schedules;
- exports of defense industry production in excess of domestic military procurement needs; and
- use of offset requirements in foreign procurement.

The low technical level of the defense industry has been another problem. Repeated claims in the late 1970s of successful test firings of the Korean surface-to-surface missile, said to be soon followed by mass production, gave way in the 1980s to more modest and realistic plans to develop an autonomous capability for development and production of precision-guided weapons and other high-technology hardware through a combination of co-production and licensing agreements with foreign companies and more selective and limited Korean R&D.

Coordination of appropriate R&D strategies is a third problem facing South Korean defense industries. Since 1979 the MND has favored diversification of R&D through greater emphasis on private sector, or "industry-led" efforts. In part this may have reflected intra-governmental conflict between the MND and the ADD and an effort to reduce the role of the latter. In 1979 the 1st Defense Industry Bureau (DIB) of the MND was tasked with coordination of research and development planning, including the encouragement of private-sector defense science research and supervision and coordination of the ADD.

e. Reduced Role for the Agency for Defense Development

In 1980, defense industry R&D was broadened to include university institutes, such as the Aerospace Industry Research Institute at Sejong University, established in 1979; government organizations other than the ADD, such as the Korean Institute of Science and Technology and the Bureau of Standards; and other organizations. Subsequent plans called for closer coordination of R&D with actual needs of the military and the capabilities of the defense industry, and for continued diversification to build a nationwide R&D network of military, industrial, and academic organizations. In 1981 the

quality control function previously divided between the ADD and the Defense Procurement Agency was unified under a new organ, the Defense Quality Inspection Office.

Plans for 1982 and 1983 required a division of responsibilities between the private sector, which would concentrate on broadened development of Korean-designed or K-series versions of basic weaponry, and government sponsored "selective" high-tech R&D projects. The 1983 plan also stated that the government would "improve and develop the structure of the ADD, which is capable of obtaining the greatest degree of research effect with the smallest amount of manpower."

All of these trends point to the reduced autonomy of the ADD and indicate a less central role for the agency than it enjoyed in the mid- and late 1970s.

3. LEGAL FOUNDATION FOR THE ARMS INDUSTRY AND FOREIGN MILITARY SALES

a. Legal Foundation

The ROK Defense Procurement Law of 1973 provided the legal foundation for government promotion and direction of South Korean defense industries. It provided for government planning and close direction of defense industry growth and provided incentives and penalties for defense industries.

Firms seeking official designation as military industries were to apply to the Ministry of Commerce and Industry, providing details of their financial condition, production and technical capabilities, facilities, and plans. In consultation with the MND, the Ministry of Commerce and Industry made an assessment of these capabilities. The consultative committee reviewed recommendations, and the Minister of Commerce and Industry issued the final certificate of designation to the petitioning company.

Designated defense industry companies enjoyed a number of incentives and privileges under the law:

- ° guaranteed production and procurement levels;
- ° access to state-owned assets for production or R&D;
- ° access to supplementary funds;
- ° incentive awards for superior technical work;
- ° long-term (5-year) procurement contracts;
- ° state payment of interest charges on loans used to obtain raw materials; and
- ° protection from labor disputes.

Designated defense industries were also subject to administrative and penal sanctions. Failure to meet security standards or to maintain government

production goals could result in loss of the privileges. The government could also withdraw designation if a company failed to carry out government directives to modify production facilities, or improperly disposed of state funds or other assets provided to assist in R&D or production. Failure to follow certain government directives or to maintain security standards could be punished by imprisonment of up to 2 years or fines of up to \$7,500 (1973). Under a system of dual culpability, such penalties applied not only to the immediately responsible person but also to company management.

Although the law required defense industries to obtain the formal recommendation of the MND in order to export defense goods, it provided no penalties for unauthorized defense exports.

b. Legal Changes in the Late 1970s

In preparation for further growth of military production and the new drive for exports, the South Korean Government began in 1977 to refine the legal and institutional framework through which it controlled and directed the defense industries. The Defense Procurement Law was amended in 1977 and 1979 to broaden the scope of official financial and technical assistance to the designated defense industries. The amendments:

- o established a defense industries' fund, originating from "government and non-governmental contributions" and managed by the MND, to secure financial resources for defense industries;
- o broadened the permissible scope of government financing to include R&D costs;
- o gave the government power to order transfer of defense industry facilities; and
- o established the Defense Industries Promotion Association, a private corporation under MND direction, and authorized it to carry out government functions (to be designated later) in managing import or export of defense goods.

The 1977 amendment also placed overseas sales of weapons and munitions under the final authority of the Ministry of Commerce and Industry, which issued export permits on the recommendation of the Minister of National Defense. The MND did not have full legal control of military hardware export permits until 1981. The legal penalty for unauthorized military exports was established in 1979 at up to 10 years of hard labor or imprisonment and a fine of up to \$103,000 (1979).

A 1979 Presidential Decree upgraded the Defense Industry Bureau (DIB) of the MND, which had existed since the early 1970s, creating three bureaus: 1st, 2d, and 3d DIBs. The 1st DIB has responsibility for providing staff support to the Assistant Minister of National Defense for Defense Industries, and for exports of military goods, including the collection of intelligence on potential markets and coordination with foreign governments. The 2d DIB coordinates MND policy with most ground equipment manufacturers and research

institutes, and the 3d DIB has similar responsibilities for companies and R&D concerned with naval and air equipment, tanks, and guided munitions.

c. Effects of the Legal Changes

These developments in the late 1970s enhanced the power of the government, and especially of the President, in management of the largely private-sector South Korean defense industry. In reviewing the proposed 1977 amendment, members of the National Defense Committee of the National Assembly pointed out that the new provisions would provide the President with a political blank check, by-passing the National Assembly and the budget process through the use of presidential decrees in many areas. The committee members also expressed concern over the implications of allowing "non-governmental contributions" to the defense industries growth fund, and noted that such a provision might legitimize the common practice of assessing major corporations for contributions to projects deemed to be in the national interest. (According to South Korean Government sources, some 37 percent of the fund total of more than \$2.7 million in 1982 was contributed by the corporate sector.) Increased criminal penalties also weakened the position of defense industry managers, although the 1979 amendment did eliminate earlier penalties for "refusal" or "avoidance" of defense contracts, and punished only "non-performance."

The legal changes in the late 1970s increased both benefits and risks for defense industry managers. The benefits of participation in the defense industry became more substantial and attractive, and the numbers of companies seeking and gaining status as "designated defense industries" continually increased during this period, to include more than 80 companies in the early 1980s. The same legal changes enhanced the power of the President to reward and punish and to intervene directly in a wide range of managerial decisions. These laws and the enhanced position of the Defense Industry Bureaus created a close supervisory relationship between the defense industries and the Ministries of National Defense and Commerce and Industry.

There also were potentially negative managerial implications. Designated defense industry companies paid for their substantial privileges with a corresponding loss of autonomy. All companies producing arms and ammunition, for example, were potentially subject to presidential intervention and supervision at every level of company structure and management. The government could order designated defense industry companies to improve, augment or expand their operations, or even to transfer their facilities to another company to meet "urgent national defense needs." Although the government was to pay compensation for these changes, such compensation could legally only provide for directly incurred outlays and could not extend to opportunity costs or to losses due to resulting economic or managerial problems.

In 1982 a published Korean study cited classified government financial analyses showing that by the late 1970s and early 1980s, the defense industries were experiencing difficulties with overinvestment, low capital turnover, excess productive capacity, and other financial and managerial ills brought about by immoderate growth and investment duplication. Officially, however, the South Korean Government continued to blame external economic and

political factors--oil price increases in 1980, US restrictions, exchange rate changes, world economic stagnation--for problems facing defense industries. By the early 1980s, arms exports, originally regarded in 1977 as a stimulus to defense industry growth and development, had become an apparent panacea for the structural ills of the defense industry.

4. LEGAL REGULATION OF MILITARY EXPORTS IN THE 1980s

a. Tightened Executive Branch Control

Until 1980, South Korean law provided for free defense industry marketing activities under a generalized export licensing system. A Ministry of Commerce and Industry regulation in June 1980 ended that system, establishing more restrictive guidelines for the export of quartermaster goods. The purpose of the regulation was "to prevent undue competition among Korean firms exporting quartermaster goods, and in expectation of increase in such exports." Firms seeking to export quartermaster goods or to participate in international bidding had to obtain prior permission on each occasion by submitting specialized application forms for approval to the Ministry of Commerce and Industry. The Ministry became empowered to revoke the export licenses of firms failing to follow these requirements or conducting trade in violation of conditions under which permission was granted.

The new guidelines suggest that the South Korean Government was displeased with the unrestrained conduct of the defense industry firms concerned and anxious over the possible impact of such marketing activities on its diplomacy and international position. The guidelines authorized revocation of export permits and licenses of firms that "provoke foreign relations problems" or that "disrupt international confidence [in Korea] or the military goods export trade." The Ministry of Commerce and Industry could also revoke designated status of firms whose activities disrupted the security or export order of the region concerned.

b. Increased Flexibility in Defense Contracting

A further revision of the Defense Procurement Law in 1983 continued the trend of increased executive branch discretion in defense contracting. This amendment expanded the scope of estimate-based contracting to include actual procurement contracts (not just R&D contracts), and provided for increased flexibility with new types of estimative contracts. This revision enhanced the President's power vis-a-vis the legislature by allowing him to conclude such contracts "notwithstanding (provisions of) the budget law or other applicable law."

c. Increased MND Control over Military Exports

In April 1981 the Defense Procurement Law was again amended to give full control over the manufacture, management, and export of military hardware to the MND. Prior to this amendment, the Ministry of Commerce and Industry issued permits for specific weapons export transactions, as well as for transactions involving quartermaster goods.

The MND retained influence on the export of quartermaster goods. In 1982, authority over exports of quartermaster goods shifted from the Ministry of Commerce and Industry to the Defense Industries Promotion Association (DIPA). The MND holds supervisory authority over the DIPA through the 1st Defense Industry Bureau.

d. Regulation of Weapons Exports

Published South Korean law does not directly deal with the problem of defense industry firms that "provoke foreign relations problems" or "disrupt international confidence or the military goods export trade" in exporting weapons and ammunition. However, it may be surmised that the rules for the quartermaster goods trade have their counterpart in controls over weapons marketing and exports. At the time of the 1980 regulation restricting quartermaster goods marketing and exports, the Ministry of Commerce and Industry was still in control of export permits for weapons exports. Given concern over disruption of ROK diplomacy or possible damage to South Korean reputation and credibility, it seems likely that exports of weapons and munitions would be more stringently regulated than exports of quartermaster goods, especially after weapons exports came under the full control of the MND in 1981. The penalty for exporting military goods without a permit is up to 10 years' imprisonment and up to \$103,000 in fines.

Within the framework of MND control of weapons exports, there is no law, administrative regulation, or authoritative policy prohibiting South Korean sale of weapons or other military goods to countries at war or in a state of tension with neighboring states.

5. MARKETING EFFORTS: PROBLEMS AND PROSPECTS

South Korean defense industries were successful in the late 1970s in concluding sales of ammunition, quartermaster goods, and naval vessels to several countries. There is little public information on the mix of government or private-sector marketing efforts in the late 1970s. Legal changes in 1980, however, suggest that the government was concerned that uncoordinated private-sector marketing and sales in such a sensitive field might injure the foreign relations position of the country, and also indicate that it desired more central direction of marketing. In 1980, the government began to control defense marketing more tightly and to conduct more openly its own marketing efforts.

a. Defense Marketing Practices

Publicity for the South Korean arms industry has proceeded under close government guidance. In 1980, the MND Defense Procurement Agency (DPA) listed for the first time an overseas sales and marketing section in its organizational table. The official DPA annual catalog of Korean-produced military goods, a full color, bilingual promotional tool, since the early 1980s has included weapons and ammunition in addition to the quartermaster, transportation, and communications equipment featured in earlier editions. In 1981 the Defense Industry Promotion Association, an incorporated trade

organization under the close supervision of the MND, sponsored a military trade fair (KODEX) in Seoul, at which Korean defense manufacturers exhibited their products to potential foreign purchasers. This exhibition was accompanied by the selective release to international journalists of normally closely-held information on South Korean arms production and trade, and by carefully targeted advance publicity. For example, prior to the exhibition, an issue of the Islamic Defence Review (London) was devoted entirely to South Korean defense industries and products. South Korea also participated in the Asian Defense Expo '80 in Malaysia and in the Defendory '82 international arms exhibition in Greece.

In general, despite these examples, South Korean defense industry advertising is conducted quietly, through company brochures and official publications apparently sent on an individual basis or distributed to prospective buyers during defense plant visits. Unlike defense companies of numerous other countries, including Brazil, Israel, West Germany, Belgium, Greece, Singapore, and Pakistan, South Korean arms manufacturers do not advertise in major international military journals. There is also little evidence of direct advertising in US trade journals, despite officially acknowledged civilian and military ammunition exports to the United States of at least \$56 million over the period 1980 to 1983.

b. The 1983 Defense Procurement Agency Catalog

The 1983 edition of the DPA arms catalog, Korean Military Supplies, states that the DPA conducts foreign sales and marketing of Korean-made military supplies in addition to its procurement role for South Korean military forces. The Korean-language introduction adds that the catalog "will show to advantage the capabilities of our defense industry to the world." The first 30 pages contain photo-essays introducing South Korean history, culture, armed services, industries, defense industries, and the DPA itself. The remaining 120 pages show South Korean defense industries products under the title "What We Procure." It is evident that the DPA will procure for foreign purchasers what it procures for the South Korean Armed Forces.

The DPA catalog follows the South Korean Government practice of exaggerating the level of technical development and degree of autonomy of South Korean defense industries. For example, the catalog gives the impression that foreign technical assistance or licensing agreements are involved in production of only two items, the Northrup Aviation F-5E/F fighter and Hughes 500MD antitank helicopter. There is no indication given that for much of the ground forces equipment and weaponry in the catalog there are proprietary restraints governing sales of US co-produced items and that purchasers may be subject to US political screening or required to provide end-use statements to the US Government (see table 4). Advertising copy accompanying US-licensed items usually notes only that the equipment is compatible with NATO equipment or has been tested in Vietnam or in NATO use. The catalog uses relationships between US equipment and Korean designs solely to enhance the impression of quality and reliability. The Korean 2½-ton truck, for example, is "derived from the world-renowned US Army M44A2 series."

Table 4

Catalog Items Not Specifying US Licensing or Co-production Agreements

<u>Category</u>	<u>Item</u>
Crew-served Weapons	Vulcan Air Defense System M167A and accompanying fire control and sighting equipment such as the M61 gun sight, AN/VPS-2 range-only radar M134 telescope and AN/TVS-5 night sight M114 howitzer (155-mm) M101A1 howitzer (105-mm) 106-mm recoilless rifle M67 90-mm recoilless rifle M30 4.2 inch mortar M291 81-mm mortar M19 60-mm mortar
Individual weapons	M203 grenade launcher for M16 M16A1 rifle M60 machinegun
Optical devices	AN/PVS-5A night vision goggles AN/PVS-4 night vision sight AN/PVS-5 night vision sight
Communications	AN/PRC-77 VHF-FM radio
Ammunition	All types and sizes, including hand grenades, fuzes and M18A1 antipersonnel mine, M19 antitank mine

[Source: Korean Military Supplies, 1983 (Seoul), u.p.]

The catalog contains a small number of ground force weapons said to be developed through Korean research. The KH179 155-mm howitzer, for example, was "developed through our technology and experience to meet the following requirements of the Korean Army." Comparison charts favorably match the firing ranges of this weapon and the Korean LDK1K1 105-mm howitzer with the US M114 and M101A1. Infantry weapons developed by South Korea include:

- K1 5.56-mm submachinegun;
- K2 5.56-mm rifle ("our newly developed K2 is a tremendously versatile product. . . .");
- K3 light machinegun; and
- K75 handgrenade (" . . . fragmentation hand grenade . . . developed by a Korean company under technical supervision of the Korean Army . . . light weight, small and easy-to-grip shape. . . .").

c. Strengths and Weaknesses

Official and semi-official weapons marketing publications such as the annual DPA catalogs or the special Islamic Defence Review of Fall 1981 show the weaknesses as well as the strengths of South Korean defense industries. From the ROK military procurement standpoint, the strengths include the fact that these industries have successfully made the transition from being suppliers of quartermaster goods to being producers and exporters of infantry weapons and munitions, military vehicles, and small- to medium-sized naval vessels. From an export standpoint, however, the South Korean defense industry has two serious drawbacks--it is centered on low-tech basic weaponry and it is still heavily dependent on licensing and co-production agreements with more developed arms producers, especially the United States. Both deficiencies sharply distinguish the South Korean defense industry from those of more technically advanced arms exporting states such as Israel or Brazil.

d. Marketing Prospects

The weaknesses of the South Korean defense industries have important marketing implications. First, US political restrictions are a significant impediment to marketing and sales. This largely accounts for the absence of open South Korean arms advertising and the hollowness of much of the sales material circulated on a limited basis. Such restrictions are imposed by Congress and cannot be eased except marginally even by sympathetic US administrations. Meeting US political and end-use requirements is not popular with many potential consumers of Korean-made weapons and is not possible for others. Moreover, the approval process, no matter how cooperatively conducted on the US side, takes valuable time.

The initial South Korean response to this problem was the development of domestically designed "K-series" weapons, like the K1 and K2 assault rifle and submachinegun. The government clearly hoped to bypass US political restrictions and royalty payments. Whatever the utility of this tactic in terms of domestic procurement, it was ill-considered from a marketing standpoint. Automatic rifles are among the most competitive weapons sold internationally, and are marketed by nearly every major world arms exporter. The market is constricted further by the fact that domestically designed automatic rifles are the first-production weapon of choice for fledgling arms industries throughout the developing world. Such weapons are currently in production or development in many countries, including Argentina, Brazil, Finland, Greece, Spain, India, Malaysia, and Singapore.

Second, and of perhaps greater long-term importance than US political constraints, the "first-generation" technical level of South Korean arms production makes it unrealistic to expect many sales of weaponry to major peacetime arms purchasers. South Korea's unrequited courtship of Saudi Arabian military delegations in the late 1970s, for example, faltered on the fact that there was little to offer wealthy clients seeking state-of-the-art weaponry. Even Saudi Arabian purchases of basic arms for use by allied states, such as a \$7 million transaction in 1983 for assault rifles from Singapore to Somalia, have not gone to South Korea. In dealing with such countries, South Korean comparative advantage continues to lie in the areas of

quartermaster goods, naval vessels, and construction rather than infantry arms.

Inability to participate in the advanced weapons market means that South Korea must sell its weapons and ammunition to less developed countries in need of basic weapons. Such countries often face serious liquidity problems and restricted military budgets. As public reports of ROK arms sales to both Iran and Iraq illustrate, countries that need to go to Seoul for their purchases of basic weapons provide at best a volatile market.

e. Diplomatic Context of Foreign Military Sales

Defense industry needs and pressures constitute only one of several factors influencing South Korean Government marketing policies and actions. Other factors include South Korean foreign policy goals and conditions in purchasing countries.

In the early 1980s South Korean foreign policy goals influencing foreign military sales policies included:

- o improvement of diplomatic ties with nonaligned nations and non-hostile Communist states;
- o improvement of South Korean oil supply security through good relations with OPEC states;
- o maintenance of South Korea's reputation as a responsible member of the international community of nations;
- o wider world support for South Korean unification policies; and
- o prevention of arms transfers to North Korea through third countries.

South Korea has often attempted to combine the goals of oil supply security, improved relations with nonaligned countries, and military sales in relations with Malaysia, Saudi Arabia, and Indonesia, and such considerations also may play a role in future relations with other oil-producing countries, such as Nigeria. Because of South Korean concerns over arms transfers to North Korea, military sales to countries such as Libya are likely to continue to take the form of construction or permanent facilities rather than weaponry or ammunition. In dealing with the United States, sales conducted with US permission are mixed with a variety of other approaches, including occasional ventures into illegal sales, diplomatic attempts to ease restrictions, and efforts to achieve indigenous production of basic weaponry or to void licensing agreements, as occurred in 1983 with Colt Industries.

f. Financing Military Sales

The deteriorating debt position of many Third World arms importers has influenced patterns of financing over the past decade. For example, there was reportedly a market increase in US military sales financed by military credits or grants between 1975 and 1979, from about 20 percent of total foreign

military sales in 1975 to nearly 40 percent by the close of the decade. This trend may have an important impact on South Korean military sales prospects.

Little is publicly known about how South Korea finances the foreign military sales of its arms industry. The South Korean Government reportedly offered preferential terms (6.5 to 7 percent) to Indonesia as part of an effort in 1980 to sell four patrol boats. The deal was not completed, probably because of the preference of key Indonesian officials for procurement from European sources.

One pattern which may prove significant is arms-for-oil barter arrangements with countries having proven reserves. Both Indonesia and Malaysia concluded long-term oil development and trade agreements with South Korea in 1983. Malaysia is to pay in oil for Korean patrol vessels currently under construction. Subsequent sales of South Korean naval vessels or other defense products to these two countries also may involve barter arrangements, especially given Malaysia's weak procurement budgets in the early 1980s and the European orientation of Indonesian procurement. A 1983 military cooperation agreement between South Korea and Nigeria also bears scrutiny for possible oil barter aspects.

Such barter deals would necessitate financial intermediation by the South Korean Government to enable South Korean manufacturers to recover production costs and profits while allowing buyers to pay all or a portion of the costs of the purchase in oil. Such arrangements would amount to an extended ROK government loan secured by the buyer's oil or natural gas reserves or by previously agreed-upon transfers and might provide an attractive alternative to the risks of granting trade credit to debt-burdened developing nations. However, such arrangements are possible with only a limited number of countries and cannot completely ease the financial problems of marketing arms to many Third World countries.